BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2003-295-W – ORDER NO. 2004-175

APRIL 7, 2004

IN RE:	Application of Georgia Water & Well Services, Inc. for Approval of an Increase in Water Rates and Charges.	))))	ORDER RULING ON REQUEST FOR AN INCREASE IN RATES AND CHARGES

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the "Commission") on the Application of Georgia Water and Well Services, Inc. ("GWWS" or the "Company"), filed on October 2, 2003, seeking approval of a new schedule of rates and charges for water service that GWWS provides to its customers within its authorized service area in Oconee County, South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-210 *et seq.* (1976), as amended, and 26 S.C. Code Regs. 103-821 (1976).

By letter dated October 17, 2003, the Commission's Deputy Executive Director instructed GWWS to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the areas affected by GWWS' Application. The Notice of Filing indicated the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings. In the letter of October 17, 2003, the Deputy Executive Director also instructed GWWS to notify directly, by U.S. Mail, each customer affected by the Application by mailing each customer a copy of the Notice of Filing. GWWS furnished the Commission with an Affidavit of Publication demonstrating that the Notice of Filing had been duly published and with a letter in which GWWS certified that it had complied with the instruction of the Deputy Executive Director to mail a copy of the Notice of Filing to all customers affected by the Application. In response to the Notice of Filing, Petitions to Intervene were filed on behalf of the Consumer Advocate for the State of South Carolina (the "Consumer Advocate") and the following customers of GWWS: Douglas Glenn, Rosellen Aleguire, Dawn Knecht, Louise Dicey, Rowena Reynolds, Kenneth Collins, and Theresa White.

S.C. Code Ann. Section 58-3-95 (Supp. 2003) provides in relevant part that "[w]henever a corporation or person furnishing … water, sewerage collection, sewerage disposal, … files a schedule setting forth proposed changes with the Commission pursuant to the procedures prescribed in this title, a panel of three members of the Commission shall hear and rule on the proposed changes." Pursuant to S.C. Code Ann. §58-3-95 (Supp. 2003), a panel of three Commissioners was appointed to hear and rule on GWWS's Application. The panel consisted of Chairman Clyburn, presiding; Vice Chairman Mitchell; and Commissioner Moseley.

On February 16, 2004, the Commission held a public night hearing on GWWS's Application in Walhalla, South Carolina, to allow members of the public to speak. On February 19, 2004, a public hearing concerning the matters asserted in GWWS's Application was held in the Commission's hearing room located at Synergy Business

Park, 101 Executive Center Drive – Saluda Building, Columbia, South Carolina. During the proceedings, GWWS was represented by William F. Austin, Esquire and Raymon E. Lark, Esquire. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire and Hana Pokorna-Williamson, Esquire. Intervenors Douglas Glenn, Rosellen Aleguire, Dawn Knecht, Louise Dicey, Rowena Reynolds, Kenneth Collins, and Theresa White are all customers of GWWS, and each appeared *pro* se. The Commission Staff ("Staff") was represented by F. David Butler, General Counsel.

At the hearing in Columbia, David Shoemaker, Secretary/Treasurer of GWWS, testified in support of the Application. Intervenor witnesses included Douglas Glenn, Rosellen Aleguire, Dawn Knecht, Kenneth Collins, and Theresa White. One customer testified as a public witness in opposition to GWWS's requested rates. The Commission Staff presented the testimony of Chris Eleazor and Bruce Bleau, both of the South Carolina Department of Health and Environmental Control ("DHEC") and both appearing under subpoena; Sharon G. Scott, an Auditor from the Commission's Audit Department; and William O. Richardson, Chief of the Water and Wastewater area of the Commission's Utilities Department. The Consumer Advocate did not present any witnesses. Following the hearing, parties were afforded the opportunity to file briefs or proposed orders, and several parties submitted briefs or post-hearing comments.

In considering the Application of GWWS, the Commission must consider competing interests. The interests of the consumers to receive quality service and a quality product at a reasonable rate compete with the interests of the provider to have the opportunity to earn a fair rate of return. Regulation, as it has developed in the United

States, is concerned with rates, service, [and] safety .... Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 171. Rate regulation has two aspects: control of the rate level (earnings) and control of the rate structure (prices). *Id.* As to the rate level, public utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a "fair" rate of return. *Id.* Collectively, these items comprise a company's total revenue requirements. *Id.* As to the rate structure, public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. *Id.* at 171-72. Such rates must be "just and reasonable," with no "undue" discrimination. *Id.* at 172.

Thus, in considering the Application of GWWS, the Commission must give due consideration to GWWS's total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair return. To this end, the Commission will review the operating revenues and operating expenses of GWWS and will endeavor to establish adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair return for GWWS based upon the record before it. Should the Commission's determination show that rates should be increased, the Commission will then design rates that will meet the revenue requirements of GWWS but that are also just and reasonable and free of undue discrimination.

II. FINDINGS OF FACT

1. GWWS is a water utility providing water service within its assigned service area in Oconee County, South Carolina, and its operations in South Carolina are

subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. § 58-5-10, *et seq.* (1976), as amended.

2. The appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002.

3. The Commission will use operating margin as a guide in determining the lawfulness of the Company's rates and in the fixing of just and reasonable rates.

4. By its Application, GWWS is seeking an increase in its rates and charges for water service which results in $72,090 of additional revenues to GWWS.

5. The appropriate operating revenues for GWWS for the test year, under present rates and after accounting and pro forma adjustments, are $84,391.

6. The appropriate operating expenses for GWWS for the test year, under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of test-year occurrences, are $77,283.

7. The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is 8.42%.

8. Based on the operating margin for the test year after accounting and pro forma adjustments, we find that GWWS has demonstrated the need for an increase in rates.

9. When applied to as adjusted test year operations, the rates requested and proposed by GWWS result in an operating margin of 39.57%.

10. The Commission finds that an operating margin of 39.57% is an unreasonable return for a water utility such as GWWS; however, the Commission finds that an operating margin of 30.00% would provide a reasonable return to the utility.

11. In order for GWWS to have the opportunity to achieve an operating margin of 30.00%, the income requirement for GWWS, under operating margin methodology found appropriate in this Order and using the adjusted operating revenues and operating expenses approved herein, is $120,741.

12. In order for GWWS to have the opportunity to earn the herein approved operating margin of 30.00%, GWWS must be allowed additional annual water service revenues of $36,350.

13. To achieve additional annual water service revenues of $36,350 and an annual income requirement of $120,741, GWWS will require a flat-rated charge of $22.56 per month.

14. The Commission finds that it is not appropriate to set a metered rate for GWWS at this time.

15. The appropriate operating margin for GWWS based upon the herein approved adjustments and rates is 30.00%.

16. The Commission finds that GWWS should maintain its books and records so that GWWS' South Carolina operations, including revenues, expenses, and assets, are separately identifiable from GWWS' Georgia operations, and, further, GWWS shall maintain its books and records in accordance with the NARUC Uniform System of

Accounts for Class C Water Utilities, as adopted by this Commission and as required by 26 S.C. Code Regs. 103-517 (Supp. 2003).

III. EVIDENCE TO JUSTIFY FINDINGS OF FACT

In this section, the Commission sets forth the evidence relied upon in making its Findings of Fact as set forth in Section II of this Order.

1. EVIDENCE FOR FINDING OF FACT 1

The evidence supporting this finding concerning the Company's business and legal status is contained in the Application filed by GWWS, in the testimony of GWWS witness Shoemaker, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. The evidence of record indicates that GWWS is a public utility within the meaning of S.C. Code Ann. Section 58-5-10(3) (Supp. 2003) and that GWWS is providing water service to customers under a schedule of rates approved by this Commission in Order No. 89-1131, Docket No. 89-232-W, dated December 12, 1989. Application at p.1. In addition, the Application and the testimony of Mr. Shoemaker show that GWWS purchased Water Systems, Inc. in January, 1993. Application, p. 1; Testimony of Shoemaker. This finding of fact is essentially informational, procedural, and jurisdictional in nature, and the matters which it involves are not contested by any party.

2. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 2

The evidence supporting this finding, that the appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002, is contained in the Application filed by GWWS and in the testimony and exhibits of the parties' witnesses.

On October 2, 2003, GWWS filed its Application requesting approval of rate schedules designed to increase flat-rated water service from $15.75 to $29.25 and to produce an increase in gross revenues of $72,090. GWWS also filed rate schedules reflecting a metered rate for water service consisting of a Basic Charge of $26.25, including 5,000 gallons of water per month, with a Commodity Charge in excess of 5,000 gallons of $3.50 per thousand gallons of water and designed to produce additional gross revenues of $56,070. The Company's Application was based on a test period consisting of the twelve-months ending December 31, 2002. *See* Application p. 2 and Exhibits to the Application. The Staff witnesses likewise offered their evidence generally within the context of the same test period. *See* Hearing Exhibit No. 9.

A fundamental principle of the ratemaking process is the establishment of a test year period. In *Heater of Seabrook v. Public Service Commission of South Carolina,* 324 S.C. 56, 478 S.E.2d 826 (1996), the Supreme Court of South Carolina noted that "[t]he 'test year' concept is very important in the rate-setting process. In order to determine what a utility's expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues." 478 S.E.2d 828 n.1 (1996). The test year is established to provide a basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Public Service Commission,* 328 S.C. 222, 493 S.E.2d 92 (1997), citing *Hamm v. S.C. Pub. Serv.*

Comm'n, 309 S.C. 282, 422 S.E.2d 110 (1992). The test year provides a basis upon which a commission staff will conduct its audit of a company's books. Phillips, *The Regulation of Public Utilities* at 196. For ratemaking purposes, only just and reasonable expenses are allowed; only used and useful property (with certain exceptions) is permitted in the rate base. *Id.* The commission must have a basis for estimating future revenue requirements. *Id.*

The Commission concludes that the appropriate test year to use in the instant proceeding is the twelve-month period ending December 31, 2002. No party contested the use of that test year as proposed by GWWS in its Application. To the contrary, all witnesses relied upon that test year period in presenting their evidence.

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 3

In its Application, GWWS did not specify or propose a particular rate-setting methodology.

"The Public Service Commission has wide latitude to determine an appropriate rate-setting methodology." *Heater of Seabrook v. Public Serv. Comm'n of South Carolina,* 324 S.C. 56, 64, 478 S.E. 2d 826, 830 (1996). South Carolina law does not require the Commission to use any particular price-setting methodology. *Id.* S. C. Code Ann. Section 58-5-240 (H) (Supp. 2003) directs the Commission to specify an allowable operating margin in all water and wastewater orders. However, "that directive does not mean that the operating margin methodology must be used in determining a fair rate of return." *Id.* Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation." *Id.* In its Application, GWWS requested Depreciation Expense of $35,627 based upon the Company's 2002 Federal Depreciation Schedule showing a total cost basis of $290,565. Application, Exhibit E. However, the Company's 2002 Federal Depreciation Schedule utilizes cost basis for determining depreciation and includes the cost which GWWS paid for the South Carolina systems. As will be discussed later, the Commission denies GWWS' request for an acquisition adjustment in this case. Thus, the net value of plant would not include the cost which GWWS paid for the system, and the net value of the plant is significantly decreased from that value shown in the Application.

The Staff in its exhibits and testimonies presented information regarding the operating margins for per books test year, test year as adjusted and after the proposed increase, and depreciation expense adjustment. *See* Hearing Exhibit No. 13, (Utilities Department Exhibit No. 6) and Hearing Exhibit No. 9, p. i (Synopsis), pp. 5-6 (Audit Exhibit AF and AM), and p. 14 (Audit Exhibit A-2). The Commission Staff also presented various alternative operating margins and associated revenue requirements for those operating margins. Typically, [the operating margin] methodology is appropriate where a utility's rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book values in excess of investment. *Heater, supra.* Due to GWWS's reduced rate base as demonstrated by Staff's depreciation adjustment worksheet showing Net Depreciable Plant of $114,121 [See, Hearing Exhibit No. 13, p. 14 (Audit Exhibit A-2)] and the fact that GWWS has not presented evidence of a rate base of sufficient size on which to utilize return on rate base as a price-setting methodology, the Commission finds that operating margin is the appropriate rate-setting methodology to use in this case.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 4

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by GWWS and in the testimony and exhibits of Staff witness Richardson.[1] The Application of GWWS indicates that it is seeking additional revenues of $72,090 from the proposed rates for its water service operations. Application of GWWS, Exhibit C. Additionally, Staff witness Richardson testified that under the rates proposed in the Application, GWWS would see an increase in revenues of $72,090. Richardson, Prefiled Testimony, p. 2, ll. 11 - 13, Hearing Exhibit No. 12, p. 2 (Utilities Department Exhibit No. 2). Both the Company and the Staff agree with the amount of the proposed increase, and no party offered any evidence to contradict this amount.

5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 5

GWWS's Application shows per book test year operating revenue of $97,777. Application, Exhibit A. Staff calculated as adjusted test year operating revenues of $84,391, of which $84,105 is attributable to service revenues and $286 is miscellaneous income from late fees, Hearing Exhibit No. 12, p. 2 (Utilities Exhibit 2).

Staff proposed an adjustment to per book operating revenues to annualize service revenues using year-end customers. Hearing Exhibit No. 12, p.2 (Utilities Exhibit 2); Hearing Exhibit 9 (Audit Exhibit A-1, p. 1 of 7). Staff's proposed adjustment results in a

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[1] As will be discussed later in this Order, the Commission has determined that a metered rate for GWWS should not be granted at this time. Therefore, the Findings of Fact and the discussions in section "III. Discussion of Evidence to Justify Findings of Fact" will only address findings and evidence related to flat–rated service.

reduction to per book operating revenues of $(36). *Id.* Staff also adjusted test year per book operating revenues to remove Safe Drinking Water Act pass-through fees administered by DHEC from revenues and expenses. *Id.* GWWS did not annualize test year revenues but reported actual test year revenues, including revenues from sources other than water service such as the Safe Drinking Water Act pass-through charges.

We find the adjustments proposed by Staff to be reasonable and adopt the Staff's adjustments. Annualizing the revenues is appropriate because annualizing the revenues has the effect of recognizing all service revenues applicable to the test year. Here the revenues were annualized to reflect the current number of customers. By annualizing operating revenues for the current number of customers, Staff gives effect for operating revenues for the current number of customers which we find to be an appropriate and acceptable method in this case. Further, we find the adjustment to remove the Safe Drinking Water Act pass-through charges appropriate. S.C. Code Ann. Section 44-55-120 (2003) provides in relevant part that "[a] water system may increase water rates to each service connection by an amount necessary to recover the cost of the safe drinking water fee without seeking approval of the public service commission." Thus state law allows recovery of the safe drinking water fee outside of rates established by this Commission. Accordingly we find that the monies collected pursuant to the allowable charges for the Safe Drinking Water Act should be removed from operating revenues upon which rates are to be established. Therefore, we approve the Staff's adjustments and find the appropriate operating revenues for the test year after accounting and pro forma adjustments are $84,391.

6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 6

The parties offered certain adjustments affecting operating expenses for the test year. GWWS witness Shoemaker and Staff witness Scott offered testimony and exhibits detailing adjustments proposed by the parties. *See* Hearing Exhibits Nos. 9, 10, and 11 (Exhibits sponsored by or admitted through Staff witness Scott) and GWWS's Application, Exhibit 4. This Section will address the adjustments offered which affect operating expenses.

(A) DHEC Fees:

(1) Position of GWWS: GWWS included DHEC pass-through fees in test year revenues and expenses.

(2) Position of Staff: Staff proposed adjustments to remove fees collected pursuant to the Safe Drinking Water Act (also known as DHEC pass-through fees) from both revenues and expenses. Staff's adjustment to expenses removed $12,411 from test year expenses.

(3) Decision of the Commission: As stated in the discussion above related to revenues, state law provides for recovery of the Safe Drinking Water fee outside of rates established by this Commission. See, S.C. Code Ann. Section 44-55-120 (2003). Accordingly, we find that expenses associated with collection of this DHEC imposed fee should be removed from test year expenses upon which rates are to be established. Therefore, we approve the Staff's adjustments and find the adjustment to remove $12,411 from Operating and Maintenance Expense ("O&M Expense") appropriate.

(B) Plant Items:

(1) Position of GWWS: GWWS requested that the Commission consider a five year depreciation of well pumps rather than the 10 year depreciation recommended by the Staff.

(2) Position of Staff: Staff recommended an adjustment to remove $3,226 from O&M Expense to remove expenses which Staff found should be classified as plant items and depreciated over the life of the assets rather than expenses during the test year.

(3) Decision of the Commission: Witness Shoemaker testified that well pump motors have to be replaced earlier than the 10 year service life utilized by Staff. According to Mr. Shoemaker it is fairly common for well pumps to be replaced in 5 years. Staff witness Richardson testified that Staff depreciated well pumps at 10 years based on suggested depreciation practices and schedules compiled by the Depreciation Subcommittee of the Committee on Engineering, Depreciation and Valuation of the National Association of Regulatory Utility Commissioners ("NARUC"). Richardson Surrebuttal Testimony and Exhibit No. 14. The evidence presented by witness Richardson reflects depreciation service life of 5 to 10 years for well pumps.

The Commission recognizes that the service life of certain assets cannot be stated with absolute certainty, thus the use of a range for service lives. Further, depreciation is a method of recovering costs of an asset over the life of the asset. Clearly, a difference of opinion exists between GWWS and Staff over how long a well pump remains in service. We, however, adopt the adjustment proposed by the Staff. This item is a matter of judgment as both positions are supported by the record. However, it is the considered judgment of this Commission that a 10-year depreciation for well pumps is appropriate. Repairs to and replacement of parts of the pump do not sufficiently justify the shorter depreciation period requested by GWWS.

(C) Dues for Operator's Certification:

(1) Position of GWWS: GWWS did not include expenses associated with this item in per book expense figures.

(2) Position of Staff: Staff proposed an adjustment of $195 to include the South Carolina dues for the operator's certification.

(3) Decision of the Commission: Upon consideration of this adjustment, the Commission finds that Staff's adjustment should be adopted. The Company is required to have a certified operator. Accordingly, the expenses for that certified operator's South Carolina dues are an expense properly recoverable through rates.

(D) Expenses for Installation of Water Line Extension:

(1) Position of GWWS: The Company proposes that the cost of a new water line extension to tie GWWS' system to the Pioneer Rural Water District ("Pioneer") be recovered through expenses as an emergency maintenance expense.

(2) Position of Staff: The Staff proposes to remove $12,758 from O&M Expense related to the installation of a water line extension at the Port Bass I Subdivision. Staff proposed to capitalize the $12,758 and $1,506 for South Carolina casual labor costs over a 40 year life of the plant. (The $1,506 for casual labor was not included by the Company in per book figures.)

(3) Decision of the Commission: GWWS urged the Commission to allow the expenditures totaling $14,264 associated with the construction of a new water line extension to be recovered as an expense item during the test year as an emergency maintenance expense. The Staff recommended that the expenditures be capitalized over the 40-year useful life of the plant installed.

According to Mr. Shoemaker, GWWS made the interconnection with Pioneer during the test year in response to customer complaints resulting from several years of extreme drought conditions. The drought conditions created reduced pressure problems on major holiday weekends at high elevations in the supply system. According to Mr. Shoemaker, GWWS installed the interconnection at the insistence of DHEC. Upon completion of the interconnection, GWWS began purchasing water from Pioneer as needed to supplement the water supply in the Port Bass I Subdivision. Mr. Shoemaker stated that GWWS proceeded with installing the interconnection on the good faith belief that the Commission would grant some rate relief to the Company in regard to the interconnection.

The Staff's adjustment is based on the classification of the interconnection as a capital expenditure and that capital expenditures should be capitalized and depreciated over the life of the plant, rather than expensed which would allow for recovery of the entire cost during the test year. As an addition to plant, Staff proposed depreciation over the estimated 40-year useful life of the asset.

Upon consideration of this adjustment, the Commission finds the recommendation of the Staff as the most reasonable and appropriate. GWWS has the responsibility of providing adequate service to its customers. While pressure problems may have been caused as a result of several years of drought, GWWS has the responsibility to provide adequate service to its customers even during periods of drought. We recognize that had GWWS been able to sink a well to boost its supply to provide adequate service rather than to install the interconnection with Pioneer that the well would have been capitalized over the life of the well. The interconnection with Pioneer is no different. In further support of capitalizing the interconnection with Pioneer over the life of the line are GWWS' plans to utilize this interconnection, as well as install other interconnections with Pioneer for other subdivisions, as back-up water supply for the future. Thus, we find that the interconnection should be capitalized and depreciated over the life of the interconnection rather than expensed during the test year.

(E) Rate Case Expense:

(1) Position of GWWS: GWWS updated rate case expenses at the hearing and proposed recovery of total rate case expenses of $14,118 amortized over 5 years. GWWS' updated rate case expenses increased the amount to be amortized found in the Staff's exhibits by $8,755.

(2) Position of Staff: The Staff proposed recovery of rate case expenses of $5,363 amortized over a five year period. While Staff acknowledged that the amortization period would normally reflect the time period between rate case, Staff noted that GWWS had owned the system for 10 years without seeking a rate case. Staff then proposed an amortization period of five years which Staff stated was a more reasonable recovery period for these expenses.

(3) Decision of the Commission: The Commission finds that the updated rate case expenses as presented at the hearing by GWWS should be adopted. Staff in its Staff report, and based upon its audit of the Company's books and records, included rate case expenses of $5,363. At the hearing, GWWS provided invoices showing an additional $8,755 in rate case expenses for total rate case expenses of $14,118. *See* Hearing Exhibit 11. Staff witness Scott stated that the invoices appeared to reflect expenses which she would normally include in rate case expenses. Staff proposed, and at the hearing GWWS agreed with, a five year amortization period of the rate case expenses.

The Commission finds that rate case expenses are a proper item for inclusion in rates. Ideally, the amortization period for the recovery of the rate case expenses should allow for recovery of those expenses between rate cases. However, it is impossible to foresee what the future holds and to state with any certainty when the Company may need to return to this Commission for rate adjustment. The current owners acquired the utility in 1993, and this is the first time the present owners have sought rate relief.

In *Hamm v. South Carolina Public Service Commission,* 309 S.C. 282, 422 S.E.2d 110 (1992), the Supreme Court of South Carolina stated

> Adjustments for known and measurable changes in expenses may be necessary in order that the resulting rates reflect the actual rate base, net operating income, and cost of capital. The adjustments are within the discretion of the Commission and must be known and measurable within a degree of reasonable certainty. Absolute precision, however, is not required.
> (citing *Michaelson v. New England Tel. & Tel. Co.,* 121 R.I. 722, 404 A.2d 799 (1979)).

While the Commission cannot state with absolute precision when the Company will return for another rate proceeding, the Commission must provide a sufficient amortization period under which GWWS may recover its expenses. The Commission finds a five year amortization period reasonable in light of the fact that the owner has owned the utility for eleven years, as of the date of the hearing, without seeking rate relief.

(F) Management Fees:

(1) Position of GWWS: GWWS proposed an annual management fee of $47,590. GWWS asserts that the previous owners were granted a monthly management fee of $1,800 during the last rate case in 1989 and that the previous owners subcontracted all repair and maintenance work to Arrington Well Drilling, a company also owned by those previous owners. Further, GWWS employs over 7 employees in Georgia who participate to some degree in managing and operating the South Carolina system. That workforce from Georgia absorbs the majority of repair and maintenance and only large repair jobs are subcontracted out to other companies. Further, GWWS asserts that if it reverted to a two employee operation in South Carolina, as was the case with the previous owners, that all the costs associated with salaries, benefits, taxes, rent, utilities, supplies, etc. would exceed the proposed management expense requested by the Company.

(2) Position of Staff: The Staff proposed an adjustment of $(25,990) to reflect a reduction in per book management fees from $3,966 per month to $1,800 per month. Staff stated that its adjustment was based on the fact that Staff was unable to verify the per book expenses to actual source documents or records because the majority of charges

and allocations were based on estimates. Staff allowed a monthly management fee of $1,800 because Staff acknowledged that the Company has no employees located in South Carolina and that expenses such as office rent, repairs and maintenance, on-call service, secretarial services, billing, and administrative costs are relatively the same type of services provided by the previous owners. In the last rate case brought by the previous owners of the system, a monthly management fee of $1,800 was approved, and Staff allowed that management fee in the instant case.

(3) Decision of the Commission: In a case for rate relief, the burden of proof rests with the utility requesting the rate relief. With respect to this issue of a management fee, Staff witness Scott testified that the books and records of the Company could not be tied to the management fee requested by GWWS. While witness Scott acknowledged on cross-examination that expenses such as billing, administration, repairs and maintenance, and on-call services are the types of expenses usually incurred by a utility, the fact remains that GWWS did not have documentation to support the requested management fee. In fact, witness Scott's testimony and exhibits reveal that the charges and allocations used by the utility were based on estimates. The utility had no records, time sheets, or other documentation on which to base the requested management fee. Further, while Mr. Shoemaker provided oral testimony that GWWS absorbs the majority of repair and maintenance labor expense through the management fee, GWWS, the party with the burden of proof responsible for showing the appropriateness and reasonableness of the request, provided no documentation to support its request to the Staff during its audit or to the Commission during the hearing.

While the Commission recognizes that absolute precision in adjustments is not required, adjustments must be within a degree of reasonable certainty. *Hamm, supra.* With regard to this issue of an appropriate management fee, the Commission concludes that GWWS has not justified its proposed management fee within a degree of reasonable certainty. Records of employees' time, invoices, or other internal reports can easily be kept which would significantly aid in making this type of determination and which would provide the element of reasonable certainty. We cannot find that an adjustment based on pure estimates meets either the known and measurable standard or the requisite standard of reasonable certainty. Therefore, we reject the management fee proposed by GWWS and accept the adjustment proposed by the Staff.

(G) Depreciation Adjustment and Acquisition Adjustment:

(1) Position of GWWS: GWWS requested an increase in the book value of plant to reflect the cost of the installation of 445 taps. In rebuttal testimony, Mr. Shoemaker requested that the Commission approve an acquisition adjustment to reflect the purchase price of $161,278 that was paid in 1993 to acquire the system.

(2) Position of Staff: In its adjustment, Staff removed the purchase price of the system from the depreciation schedule because no acquisition adjustment had been approved by the Commission. Staff also determined that the original cost of the plant as purchased would be fully depreciated in the test year. Staff further reduced the remaining depreciable plant by the amount of cumulative tap fees; Staff booked the cumulative tap fees as contributions in aid of construction. Staff's initial adjustment to per book depreciation expense was a reduction of $(35,160), resulting in as adjusted Depreciation

Expense of $467. In surrebuttal testimony, witness Scott revised the Staff's adjustment to include the tap fees from 45 taps installed by the current owners in plant in service. Witness Scott testified that GWWS had proposed to use 445 taps which included 400 taps installed by the previous owner and 45 taps installed by GWWS. Staff concluded that the taps installed by the pervious owners were booked correctly, but Staff revised its adjustment to allow 45 taps at the estimated tap fee cost of $670 in plant in service. Depreciating the taps over the useful life of the plant of 40 years, as recommended by the Utilities Department Staff, Staff recomputed its Depreciation Expense Adjustment for net allowable Depreciation Expense of $4,422.

(3) Decision of the Commission: With regard to the acquisition adjustment requested by GWWS, the Commission finds that an acquisition adjustment should not be allowed. An acquisition adjustment is the difference between the net book value at acquisition, reduced by Contributions in Aid of Construction, and the purchase price of the plant in service. If a regulatory agency determines that the cost was reasonable and beneficial to the customers, an above-the-line expense could be allowed as an Amortization of Utility Acquisition Adjustments. Scott Direct Testimony, P. 8, ll. 4-11.

GWWS asserts that the acquisition adjustment should be allowed because the acquisition of the utility by GWWS has been cost effective and beneficial to the customers because GWWS has provided water for the four subdivisions for 10 years without seeking any rate increase. Staff stated that removing the Company's purchase price of the system and replacing that cost with the original cost of the plant of $89,984 to the first owner ensures that the ratepayers only pay for the plant once through depreciation expense.

The Commission finds the explanation of the Staff reasonable and adopts the Staff's position with regard to the acquisition adjustment. "The prevailing rule relating to the acquisition of utility plant previously used in a regulated business is that the plant must continue to be recorded at the depreciated original cost to the first owner devoting the property to public service." Leonard Saul Goodman, *The Process of Ratemaking,* Vol. II, (1998) at 787. The Commission further notes that regulatory accounting and accounting for tax purposes are different. It is not inappropriate for the Company to use its cost basis with regard to accounting for tax purposes; however, regulatory accounting which is used in the setting of rates, requires different considerations. As the Staff stated as reasoning for denying the acquisition adjustment, we find it appropriate and proper that ratepayers only pay for the plant in service once through depreciation expense. Otherwise, ratepayers could pay for the same plant again and again each time a system is sold to another entity. The fact that the Company chose not to seek rate relief prior to the instant proceeding is not a "benefit" to the customers that would give rise to allowance of an acquisition adjustment.

With regard to Depreciation Expense related to the tap fees, Staff witness Scott acknowledged on cross-examination that GWWS had provided additional documentation showing that GWWS had installed 60 taps instead of 45 taps. Based on this acknowledgement of 60 taps being installed by GWWS, the Commission approves that 60 taps at the tap fee cost of $670 per tap be added to plant in service. The Commission finds inclusion of these 60 taps appropriate as the plant reflected through the cost of these taps were not included in the original cost of the plant and the value of these taps should properly be added to plant in service. Based on the revised number of taps, we adopt a recomputed Depreciation Expense Adjustment of $(30,165) resulting in net allowable Depreciation Expense of $5,462.

(H) Property Taxes and Income Taxes:

(1) Position of GWWS: The Company included property taxes associated with non-utility property in operating expenses.

(2) Position of Staff: The Staff proposed an adjustment to remove $(2,000) of property taxes from Taxes Other Than Income. Staff proposed this adjustment to remove property taxes for non-utility property from operating expenses. Staff also computed income taxes on the accounting and pro forma adjustments using a 5% tax rate for state income taxes and step rates of 15%, 25%, and 34% for federal income taxes.

(3) Decision of the Commission: The Commission adopts the adjustments proposed by the Staff. The Commission concludes that property taxes associated with non-utility property should not be included in operating expenses. Because non-utility property is not used and useful in providing the regulated services of the utility, expenses associated with non-utility property should not be included in operating expenses, which are a necessary factor in setting rates. Further, the Commission finds the state and federal tax rates proposed and utilized by Staff are appropriate for this proceeding.

Summary of Adopted Adjustments to Expenses:

The total effect of the adjustments to test year expenses adopted herein reduce Operation and Maintenance Expense by $(28,395); reduce test year General and Administrative Expense by $(22,971); decrease Depreciation and Amortization Expense by $(30,165); decrease Taxes Other Than Income by $(2,000); and increase Income Taxes by $1,696. The net effect of the adjustments adopted herein on Total Operating Expenses is to decrease test year Total Operating Expenses by $(81,835). Thus, Total Operating Expenses for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences are $77,283.

7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 7

The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is 8.42%. The calculation for the operating margin using the test year as adjusted operating revenues of $84,391 as approved herein and test year as adjusted operating expenses of $77,283 as approved herein results in an operating margin of 8.42%.

The following table indicates (1) the Company's gross revenues for the test year after adjustments approved herein, under the presently approved rate schedules; (2) the Company's operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences approved herein; and (3) the operating margin under the presently approved schedules for the adjusted test year:

TABLE A

	Before Increase
Operating Revenues	$ 84,391
Operating Expenses	77,283
Net Operating Income/(Loss)	$ 7,108
NET INCOME/(LOSS) FOR RETURN	$ 7,108
Operating Margin	8.42%

8. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 8

Based upon Finding of Fact 7, we find that GWWS has demonstrated a need for rate relief in the form of a rate increase. Adjusted test year operations reveal an operating margin of 8.42%. As noted earlier in this Order, public utilities are entitled to cover all allowable operating costs and to have an opportunity to earn a "fair" rate of return. Charles F. Phillips, Jr., *The Regulation of Public* Utilities, (1993) at 171. Public utilities are permitted to establish rates that will cover their revenue requirements. *Id.*

GWWS has testified that it intends to meter the system and provide other upgrades to its system. GWWS will need the ability to attract capital in order to make improvements to its system. On that basis and on the requirement that this Commission provide for a fair rate of return for the Company, we find that GWWS has demonstrated a need for rate relief in the instant proceeding.

9. EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 9 and 10

The flat-rated rates proposed and requested by GWWS produce an operating margin of 39.57% when applied to adjusted test year operations. The effect of the proposed rates when applied to as adjusted test year operations of GWWS is calculated by dividing Net Operating Income for Return minus Interest Expense by Total Operating Expenses. Based on the adjustments approved herein and after the proposed increase, Net Operating Income for Return is $61,584 and Total Operating Expenses are $94,057[2]. The calculation for Operating Margin after the proposed increase and with the adjustments approved herein produces an Operating Margin of 39.57%.

The Commission finds that a 39.57% operating margin is an unreasonable return for a water utility. However, the Commission in establishing an operating margin for a utility must consider the needs of the utility, the service provided by the utility, and the interest of the customers. The Commission is also mindful of the level of rates resulting from varying operating margins. The Staff in its exhibits provided the Commission with alternative operating margins for the Commission's consideration. See, Hearing Exhibit No. 13. For flat-rated monthly service, the Staff provided information of alternate Operating Margins of 20.00%, 30.00%, and 40.00%, including requisite income requirements and rates required to reach those income requirements.

In the present case, the Commission is being requested to increase rates so that GWWS may continue to provide water service to its 445 customers located in four subdivisions in Oconee County, South Carolina. While the Company's adjusted operations yield a positive operating margin, that operating margin is not, in the opinion of this Commission, a fair return for the Company and does not provide GWWS with the financial ability to attract necessary capital for GWWS to make the intended improvements, such as meters, to the system.

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[2] Adjusted Total Operating Expenses are $94,057. This includes Income and Gross Receipts Taxes calculated at $18,470. Adjusted Operating Expenses before taxes are $75,587.

However, the Commission is not without sympathy for the customers. The Commission recognizes that the customers are being requested to pay more for water service. However, the documentation provided in this case, along with the standards of ratemaking, substantiate the need for a rate increase. The Commission must allow for the viability of a utility so that the utility can provide the services which the utility is required to provide.

The Commission recognizes that it must consider the value of the services provided as well as recognize that there is a limit to what the public can bear. The Commission must strike a balance between the revenue needs of the utility and the value of the service to the public. The 39.57% Operating Margin produced by the full requested increase and with adjustments approved in this Order would result in flat-rated monthly rates of $29.25. The Commission recognizes that those rates represent an 85.71% increase over present rates. The Commission is of the opinion, under the circumstances of the present case, that a monthly rate of $29.25 representing an 85.71% increase is not an appropriate balance between the revenue needs of the utility and the value of the service to the public. The Commission cannot approve an Operating Margin of 39.57% which would reflect the Company's full rate request. Therefore, the Commission finds a 39.57% Operating Margin unreasonable.

When considering that GWWS is facing significant capital expenditures to provide upgrades to the system, such as meters and additional interconnections with Pioneer for a back-up water source, the Commission finds that GWWS has demonstrated a need for a rate increase. The Commission can appropriately consider that GWWS will need to show financial viability and an ability to repay debt in order to obtain necessary financing for the capital projects which should result in improved service to the Company's customers. While the Commission concludes that the full requested increase yielding an Operating Margin of 39.57% is unreasonable, the Commission does conclude that the needs of the Company warrant approval of an Operating Margin of 30.00%. The Commission concludes that an approved operating margin of 30.00% will provide a reasonable and fair return and should allow GWWS to obtain any necessary financing to make its planned capital improvements.

In further support of the 30.00% Operating Margin, the Commission is mindful of the rates which will be required to produce a 30.00% Operating Margin. An Operating Margin of 30.00% will require an income requirement of $120,741, with resulting flat-rated monthly rates of $22.56. See, Findings of Fact 11 and 13 and corresponding discussions under section "III. Evidence to Justify Findings of Fact." A flat-rated monthly rate of $22.56 is a 43.24% increase over the present rate of $15.75. We conclude that the herein approved monthly flat rate of $22.56 is an appropriate and reasonable value for the services which GWWS provides to the public.

At the close of the hearing, counsel for the Consumer Advocate moved that the Commission limit approval of the Company's request to a 6.00% Operating Margin. The Consumer Advocate's Motion was based upon Exhibit C to the Company's Application which demonstrates the Company's calculation of 6.00% being the Operating Margin resulting from the flat rate requested increase and the Company's pro forma adjustments. The Commission, however, must deny the Motion of the Consumer Advocate. The

Commission finds that the 6.00% Operating Margin as calculated in Exhibit C of the Company's Application does not limit or cap the Operating Margin which this Commission may approve. Exhibit C of the Application is the schedule detailing the pro forma adjustments of the Company in its Application. It does not propose to limit the request of the Company to the calculated Operating Margin reflected on that schedule.

10. EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT 11 AND 12

Using the Operating Revenues and Operating Expenses approved herein, the Commission is able to calculate the income requirement for the Utility. Operating Margin is achieved by dividing net operating income for return minus interest expense by total operating revenues. Thus the revenue requirement for GWWS under operating margin methodology found appropriate in this Order and using the adjusted operating revenues and operating expenses approved herein is calculated as $120,741 for the opportunity to achieve the 30.00% Operating Margin found reasonable in this Order.

In order for GWWS to achieve the requisite income requirement to have the opportunity to earn the herein approved Operating Margin, GWWS must be allowed additional annual water service revenues of $36,350.[3]

11. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 13

In order to achieve the additional annual water service revenues of $36,350 and an annual revenue requirement of $120,741, the Commission must design rates which will produce the required revenue requirement. In a flat-rate rate structure, the Commission utilizes the test year billing units to calculate a flat rate for water service. Therefore, the

[3] The additional revenues stated are revenues in addition to as adjusted test year Operating Revenues.

Commission calculates a flat-rated charge of $22.56 per month. This charge for monthly water service will provide GWWS with the opportunity to earn the revenue requirement required to produce the herein approved operating margin of 30.00%.

12. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 14

By its Application, GWWS requested approval of not only a flat rate for water service but also a metered rate for water service. GWWS provided testimony through Mr. Shoemaker of plans of the Company to install meters in all subdivisions in its service area. However, the fact is that GWWS has not yet installed meters in its service area. Further, there is no guarantee as to when the installation of meters will begin, let alone be completed, in any subdivision. Because GWWS cannot guarantee when meters will in fact be installed, the Commission declines to establish a metered rate for GWWS at this time.

13. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 15

S.C. Code Ann. Section 5-240(H) (Supp. 2003) provides, in part, that "[t]he [C]ommission shall specify an allowable operating margin in all water and wastewater orders." Table B, which follows, reflects the herein approved Operating Margin of 30.00%:

TABLE B

	After Increase
Operating Revenues	$ 120,741
Operating Expenses	84,516
Net Operating Income/(Loss)	$ 36,225
Customer Growth	0
NET INCOME/(LOSS) FOR RETURN	$ 36,225
Operating Margin	30.00%

14. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT 16

The Commission finds that GWWS should begin maintaining its books and records so that the Company's South Carolina operations, including revenues, expenses, and assets, are separately identifiable from the Company's Georgia operations. According to the testimony of Staff witness Scott and responses of GWWS to the Consumer Advocate's Interrogatories (See, Hearing Exhibit No. 5), GWWS does not maintain records specific to its South Carolina operations. We find that GWWS should maintain its books and records so that its South Carolina operations are separately identifiable from the Georgia operations of the Company. Further, the Company shall maintain its books and records using the NARUC Uniform System of Accounts as required by 26 S.C. Code Regs. 103-517 (Supp. 2003). Finally, we advise GWWS to consult with the Staff if guidance is needed concerning maintaining records specific to the Company's South Carolina operations or concerning the requirements of the NARUC Uniform System of Accounts.

IV. CONCLUSIONS OF LAW

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:[4]

1. Operating Margin is the appropriate guide for the Commission to use in determining the lawfulness of the rates of GWWS and in fixing of just and reasonable rates for GWWS to charge its customers in South Carolina.

[4] The Commission's analyses which give rise to the Conclusions of Law are contained in the discussions of Section III of this Order.

2. A fair Operating Margin for the water operations of GWWS in South Carolina is 30.00%.

3. For the test year of December 31, 2002, the appropriate operating revenues, under present rates and as adjusted in this Order, are $84,391, and the appropriate operating expenses, under present rates and as adjusted in this Order, are $77,283.

4. Using the 30.00% Operating Margin found to be fair and reasonable in this Order, the revenue requirement for GWWS is $120,741.

5. In order for GWWS to have an opportunity to earn the Operating Margin found reasonable and approved in this Order and to meet the revenue requirements associated with a 30.00% Operating Margin, GWWS must be allowed additional annual water service revenues of $36,350.

6. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. A monthly flat-rated charge of $22.56 is approved for GWWS.

8. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate Operating Margin for GWWS on its South Carolina operations is 30.00%

9. GWWS shall maintain its books and records so that GWWS' South Carolina operations, including revenues, expenses, and assets, are separately identifiable from GWWS' Georgia operations, and further, GWWS shall maintain its books and

records in accordance with the NARUC Uniform System of Accounts for Class C Water Utilities, as adopted by this Commission and as required by 26 S.C. Code Regs. 103-517 (Supp. 2003).

IT IS THEREFORE ORDERED THAT:

1. GWWS is granted an increase in rates and charges as provided herein for its water operations in South Carolina.

2. The schedule of rates and charges attached hereto as Appendix A are hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2003).

3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. GWWS shall maintain its books and records so that GWWS' South Carolina operations, including revenues, expenses, and assets, are separately identifiable from GWWS' Georgia operations, and further, GWWS shall maintain its books and records in accordance with the NARUC Uniform System of Accounts for Class C Water Utilities, as adopted by this Commission and as required by 26 S.C. Code Regs. 103-517 (Supp. 2003).

5. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Mignon L. Clyburn, Chairman

ATTEST:

Bruce F. Duke, Executive Director

(SEAL)

APPENDIX A

Georgia Water & Well Services, Inc
259 Wynburn Avenue
Athens, GA 30601

Filed pursuant to Docket No. 2003-295-W – Order No. 2004-175
Effective Date of Order: April 7, 2004

RATES FOR WATER SERVICE:

Monthly Flat Rate per Tap	$22.56 per month
Tap Fee	$670.00
Reconnection Charge	$125.00